BEFORE THE FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

REPLY COMMENTS OF THE
COALITION OF STATE TELECOMMUNICATIONS ASSOCIATIONS
AND RURAL TELEPHONE COMPANIES

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I. INTRODUCTION TO REPLY COMMENTS

These Reply Comments are filed on behalf of the Coalition of certain state telecommunications associations. The state associations joining in these Comments include the following: California Telephone Association Small Company Committee, Colorado Telecommunications Association, Oregon Telecommunications Association and the Washington Independent Telephone Association. Certain rural telephone companies from the State of Alabama also join in these Comments.[1] Collectively, the state associations and rural telephone companies will be referred to in these Reply Comments as the Coalition.

The Coalition's Reply Comments will address three subjects. The first is whether it is appropriate to take <u>any</u> action at the present time on either moving from embedded costs or changing the definition of rural telephone company. Second, these Reply Comments will discuss several of the opening Comments addressing the movement from embedded costs to forward-looking costs for rural telephone companies. Third, these Reply Comments will review certain of the opening Comments that were filed on the subject of the redefinition of the term "rural telephone company."

[1] As identified in the Coalition's Opening Comments, the Alabama companies include Ardmore Telephone Company, Inc., Blountsville Telephone Company, Inc., Brindlee Mountain Telephone Company, Butler Telephone Company, Inc., Castleberry Telephone Company, Inc., Farmers Telephone Cooperative, Inc., Frontier Communications of Alabama, LLC, Frontier Communications of Lamar County, LLC, Frontier Communications of the South, LLC, Graceba Total Communications, Inc., Gulf Telephone Company, Inc., Hayneville Telephone Company, Inc., Hopper Telecommunications Company, Inc., Interstate Telephone Company, Millry Telephone Company, Inc., Mon-Cre Telephone Cooperative, Inc., Moundville Telephone Company, Inc., National Telephone of Alabama, Inc., New Hope Telephone Cooperative, Inc., Oakman Telephone Company, Otelco Telephone LLC, Peoples Telephone Company, Roanoke Telephone Company, Inc. and Valley Telephone Co., LLC. Although not a rural telephone company, CenturyTel of Alabama, LLC joins in the comments.

II. IN THE CURRENT ENVIRONMENT, THE JOINT BOARD SHOULD NOT MOVE FORWARD ON A TRANSITION FROM EMBEDDED COSTS TO FORWARD-LOOKING COSTS OR REDEFINING THE TERM "RURAL TELEPHONE COMPANY"

The vast majority of the comments that were filed in October urged the Joint Board not to take action. Many of the comments filed by the incumbent local exchange carrier (ILEC) portion of the industry urged that no action be taken for substantive reasons. For example, the Western Telecommunications Alliance correctly points out that embedded costs will encourage investment far more effectively than a forward-looking economic cost model.[2] Others pointed out that there is no forward-looking cost model that has been found to be ready for use for rural telephone companies. The Synthesis Model has specifically found to be wanting.[3] Many others, such as OPASTCO, argue that there is no pressing reason to change the definition of rural telephone company for universal service funding purposes.[4]

Several comments in the initial round recommend that the Joint Board not move forward for procedural reasons. For example, AT&T urges the Joint Board not to take action until the Federal Communications Commission has finished addressing intercarrier compensation and has completed the Commission's docket concerning rural high-cost support mechanism and the designation of eligible telecommunications carriers, which AT&T refers to as the "ETC/high-cost notice."[5] Other comments agree on the importance of deciding the intercarrier compensation docket first. See, for example, the Comments of Sandwich Isles Communications, Inc. and the Comments of OPASTCO.[6]

[2] Comments of Western Telecommunications Alliance beginning at p. 10.
[3] Comments of GVNW Consulting, Inc. at p. 9.
[4] See, Comments of the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) at p. 3-7. In addition, see, e.g., Comments of CenturyTel, Inc. at p. 13-17, and the National Telecommunications Cooperative Association Initial Comments at p. 4, among others.
[5] Comments of AT&T Corp. at p. 3.
[6] Comments of Sandwich Isles Communications, Inc. at p. 10 and OPASTCO's Comments at p. 25.

Nextel Partners recommend that a new Rural Task Force be established for the purpose of developing a new rural high-cost support methodology. This recommendation is apparently in lieu of proceeding with the issues identified by the Joint Board in this proceeding.[7]

Even Western Wireless seems to say that this proceeding is the wrong docket at the wrong time. In its Comments, Western Wireless argues that there ought to be a comprehensive look at the rural high-cost support system, which suggests that moving forward on this docket is looking at the wrong issue.[8]

The Comments of the National Exchange Carrier Association, Inc. (NECA) recommend that the Joint Board focus its efforts on developing comprehensive and future-oriented universal service policy that ensures that rural customers are not left behind in the twenty-first century.[9] NECA goes on to point out that there is no compelling reason to rush on these issues. As stated by NECA,

> No rule or law mandates that the Commission adopt a new rural carrier support mechanism by mid-2006. Furthermore, no one seriously contends that current mechanisms inhibit the ability of carriers to deliver quality in advance services to America's highest cost areas. Indeed, in terms of service delivery, the RTF Order plan is a great success.[10]

NECA concludes this portion of its Opening Comments by noting that the questions under current consideration constitute an exercise that "fundamentally loses sight of the forest for the trees." NECA states: "What is needed, and what is missing, is a thorough examination into the

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[7] Comments of Nextel Partners, Inc. at p. 8-9.
[8] Western Wireless Comments on Reform of the Rural High-Cost Support System. The Comments of CTIA-The Wireless Association™ echo much of Western Wireless' Comments. Of course, Western Wireless and CTIA suggest some ridiculous transitional rules. Those transitional rules should be ignored. However, the main message is that it is not the time to act on the definition of rural telephone company or picking a new forwarding looking cost model support.
[9] Comments of the National Exchange Carrier Association, Inc. at p. 3.
[10] NECA at p. 5.

purposes and goals of a universal service system that should ensure comparable services at comparable prices for rural America into the 21st Century."[11]

To put it succinctly, if AT&T, one of the biggest proponents of moving ILECs to forward-looking economic costs for universal service funding purpose, says the time is not right, then the Joint Board should listen to AT&T and the majority of other Commenters who all say that no action is needed at the present time on the issues before the Joint Board.

III. THERE IS NO EMPIRICAL SUPPORT FOR MOVING OFF OF EMBEDDED COSTS TO A FORWARD-LOOKING COST MODEL FOR PURPOSES OF RURAL TELEPHONE COMPANIES' UNIVERSAL SERVICE SUPPORT

A. No Party Has Demonstrated that a Forward-Looking Cost Model Exists that Produces Reliable Cost Estimates for Rural Telephone Companies.

The fact of the matter is that no forward-looking cost model exists that can be said to provide an accurate prediction of forward-looking costs for rural companies. Many of the Commenters in the initial round pointed out that an extensive examination of the Synthesis Model by the Rural Task Force came to the following conclusion:

> The aggregate results of this study suggest that, when viewed on an individual rural wire center or an individual Rural Carrier basis, the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. In fact, much of the data analyses suggest that the model results tend to be in the high and low extremes, rather than near the expected results for the area being analyzed. While it may be technically possible to construct a model with added precision and variables to account for the differences among Rural Carriers, and between non-Rural Carriers and Rural Carriers, it is the opinion of the Task Force that the current model is not an appropriate tool for determining forward-looking costs of Rural Carriers.[12]

Almost all of the parties providing comments recognize that there are deficiencies in the existing

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[11] NECA at p. 9.

[12] See, e.g., Comments of GVNW Consulting, Inc. at p. 11, citing "A review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies, Rural Task Force White Paper 4, September 2000 at p. 10. See, among others, Comments of FairPoint Communications at p. 7.

economic cost models as they apply to rural companies. For example, Sprint, a staunch advocate of the use of forward-looking cost models, recognizes the existing models are not useful. Instead, Sprint advocates use of a benchmark based on price cap company costs.[13]

The Commission recognized in 2000 that there was insufficient information available to construct a workable forward-looking cost model for rural carriers. TDS points out that circumstances are no different today:

> The passage of time since the Rural Task Force Order was released has not changed that situation. The circumstances cited by the Rural Task Force in 2000 remain fully applicable today: rural carriers operate in diverse geographic, economic and regulatory circumstances; the appropriate inputs for a rural forward-looking cost model are not apparent; and small changes in inputs would yield significant variation in the level of support recovered by rural carriers. In short, there is no more evidence today than in 2001 that a workable forward-looking cost model could be developed that would ensure "specific, predictable, and sufficient" support for rural carriers.[14]

FairPoint Communications makes a very good point that even the Commission's use of TELRIC in other areas is fraught with problems. FairPoint calls attention to the FCC's September 2003 Notice of Proposed Rulemaking seeking input on the TELRIC methodology ("TELRIC Notice"). FairPoint cites to four statements that the FCC made in its TELRIC Notice:

- To the extent that the application of our TELRIC pricing rules distorts our intended pricing signals by understating forward-looking costs, it can thwart one of the central purposes of the Act: the promotion of facilities-based competition.
- We tentatively conclude that our TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent's network in the development of forward-looking costs.

[13] Comments of Sprint Corporation at p. 3-4.
[14] Comments of TDS Telecommunications Corporation at p. 8.

- The UNE pricing methodology, while forward-looking, must be representative of the real world and should not be based on the totally hypothetical cost of a most-efficient provider building a network from scratch.
- We ask parties to discuss whether a regimen focused more closely on the existing network of an incumbent LEC would be easier for state commissions to implement than the current TELRIC regime.[15]

FairPoint correctly concludes that all of the problems that the FCC delineated in its TELRIC Notice are present in the Commission's forward-looking Synthesis Model.

The Coalition agrees with FairPoint and others that argue that the Synthesis Model and other forward-looking economic cost proposals are not ready in any shape or form to address, with any reliable degree of accuracy, the costs of providing service by rural telephone companies in rural and high-cost America. Movement to a forward-looking cost model is not supported by any significant evidence. Indeed, the evidence suggests just the opposite – the transition to forward-looking costs is not warranted.

B. Use of an Arbitrary Dividing Line for Size of Rural Telephone Company Does Not Make Forward-Looking Cost Models any more Accurate.

It is interesting that those entities filing Comments that support the use of forward-looking economic costs for some segment of rural telephone companies recognize that there needs to be a dividing line below which the problems of the Synthesis Model and other forward-looking economic cost theories become too unreliable. For Verizon, that is at the one hundred

[15] Comments of FairPoint Communications at p. 9, citing from the FCC's Notice of Proposed Rulemaking, WC Docket No. 03-173, Released September 15, 2003.

thousand line level.[16] For NASUCA, the line is drawn at fifty thousand access lines.[17] For Sprint, the dividing line is price cap companies.[18] What all of these proposals have in common is that they recognize that there is a fundamental degree of unreliability in the Synthesis Model and other forward-looking cost theories.

What these proposals do not do is to persuasively evaluate why <u>any</u> rural telephone company should be subject to forward-looking economic cost models. Verizon concludes without much, if any, in the way of analysis that carriers with over one hundred thousand access lines in a state must be able to average their costs sufficiently so that forward-looking economic cost models are sufficiently accurate for use for those companies.[19] Neither NASUCA nor Verizon explain why the deficiencies in the forward-looking economic cost models are suddenly eliminated just because a company has fifty thousand or one hundred thousand access lines in a state. The truth is that if those access lines are spread out over numerous small wire centers without the densities to gain efficiencies, the Synthesis Model is no better a predictor of costs for these larger rural companies[20] than it is for a rural company with four thousand lines. Apparently, the thought is that the errors of the Synthesis Model (or other forward-looking cost model) will average out, with some errors on the high side and some errors on the low side, for a company of fifty thousand or one hundred thousand access lines. However, there is no empirical evidence of that happening. Without strong empirical evidence, the assumption cannot be adopted as fact.

[16] Comments of Verizon at p. 4.
[17] Comments of the National Association of State Utility Consumer Advocates on Rules Relating to Rural High-Cost Universal Service Support at p. 22 and following.
[18] Comments of Sprint Corporation at p. 3-4.
[19] Comments of Verizon at p. 11.
[20] The key is the relative size. A rural company may be relatively large at 100,000 lines compared to a 4,000 line company. However, 100,000 access lines is nowhere near the 1,000,000 plus lines that non-rural companies typically serve in a state.

NASUCA also advances the recommendation that rural companies that serve an urbanized or suburban area as defined by the Census Bureau should fit into the same camp as the rural carriers with more than fifty thousand lines. In other words, they would move to a forward-looking economic cost model on this basis alone.[21] That thought is unsupported. As pointed out in the Coalition's Opening Comments, such an approach does not recognize the realities faced by companies in many states. For example, in Washington, Mashell Telecom, Inc. serves the foothills of Mt. Rainier. The area it serves, which is some one hundred square miles, happens to lie within Pierce County, an urbanized area as defined by the Census Bureau. Yet there is nothing urban about Eatonville, Washington. This service area is approximately forty-five minutes in driving time through the hills to reach the populated areas of Pierce County, such as the cities of Tacoma and Puyallup. However, it is still within Pierce County and, thus, an urbanized area.

As pointed out in the Coalition's Opening Comments, there are numerous companies in the State or Oregon that fall within an urbanized area yet serve very rural portions of the State of Oregon. In Oregon, the counties of Clackamas, Lane, Marion, Multnomah and Washington are defined as within an MSA. While these counties contain the urban cities of Portland and Salem, the counties are quite large and include large tracts of rural land. Use of an MSA definition would potentially remove eleven small telephone companies in Oregon from the definition of a rural telephone company. These companies range in size from 649 access lines to under 12,000 access lines for the largest company. They serve predominantly rural farming communities. This would deprive universal service support to such small communities as Scio (1,897 access lines), Monitor (743 access lines) and St. Paul (649 access lines). These are very rural

[21] Comments of the National Association of State Utility Consumer Advocates on Rules Relating to Rural High-Cost Universal Service Support at p. 20.

communities without the advantages of economies of scope and scale enjoyed by the urban areas of those same counties.

In Colorado, Adams County, Arapahoe County, El Paso County and Jefferson County are among the counties that are designated as within an MSA. Adoption of the definitions suggested by the Joint Board would potentially remove at least six rural telephone companies from the rolls of those allowed to receive high cost support. Again, these are companies that are serving predominantly rural areas with low densities but happen to fall within a more densely populated county where the RBOC serves the densely populated portions, not the rural companies.

The problem with the Census Bureau definition is that it relies on county boundaries. There are many urbanized areas as defined by the Census Bureau that have a sufficiently large population center within a geographically large county that on average the county meets the Census Bureau's definition for urbanized area, but have distinct urban and rural areas. This is underscored by the fact that in both Washington and Oregon there are zoning concepts dealing with urban growth areas that require low densities in the more rural parts of counties. These are the areas typically served by the rural telephone companies. Growth is discouraged in those areas as a matter of state land use philosophy. NASUCA's recommendation should not be adopted.

In addition, it is interesting that NASUCA recognizes that Alaska should be different because of its geological and climatological challenges.[22] Those same geographical (topological) and climatological challenges exist in states like Washington, Oregon and Colorado as well. Companies such as Mashell, mentioned earlier, Kalama Telephone Company, Western Wahkiakum Telephone Company and Inland Telephone Company in Washington; Pine

[22] Comments of the National Association of State Utility Consumer Advocates on Rules Relating to Rural High-Cost Universal Service Support at p. 22.

Telephone Company, Eagle Telephone Systems, Asotin Telephone Company and others in Oregon, and virtually every rural telephone company in the State of Colorado have to deal with challenges that closely resemble what any rural telephone company in Alaska has to deal with. There is severe terrain and there is very cold and very inhospitable weather conditions in all of these locations.

C. There is No Justification for Moving from Embedded Costs.

In the final analysis, it just makes no sense to conclude that the Synthesis Model, or any other forward-looking economic cost model, is appropriate at this time for use with any rural telephone company. On the other hand, the use of embedded costs does, in fact, work. What happens is that any efficiencies that are gained by a larger company are passed through and become part of a lower cost level. Efficiency gains means that universal service support is lowered. The perfect example is Sprint Florida, the Joint Board's poster child, that has sufficient efficiencies that it does not draw from the universal service fund.[23]

As NECA points out, embedded costs are reliable as a known and auditable means of verifying cost levels. On the other hand, a forward-looking cost model might not be as reliable. As stated by NECA:

> It is imperative, furthermore, that costs be subject to verification. As collector of cost data, NECA is concerned about any move to a system that might rely on estimates of hypothetical costs or other systems that make it more difficult to confirm reported costs by reference to audited financial statements.[24]

Further, as TDS points out, the administrative burdens for moving to a forward-looking proxy model are very high. There is an extreme level of complexity in identifying appropriate

[23] Comments of Sprint Corporation at p. 8-9.
[24] Comments of the National Exchange Carrier Association, Inc. at p. 14.

inputs for a rural forward-looking proxy model. The Commission would need to develop appropriate safety valves and transition mechanisms. At the state level, regulators would need to reevaluate rural company rates to take into account universal service shortfalls that may result. The rural telephone companies would need to expend significant resources to learn about and apply new cost models. The rural companies would have to evaluate the impact of a new model on their operating revenue and investment plans.[25]

It is an interesting comment that the wireless companies argue that it is appropriate to force the types of administrative costs outlined above onto the rural telephone companies. However, at the same time, those same wireless companies vehemently object to the simple proposition that for wireless companies to receive universal service funding, they need to demonstrate their own costs. In any event, there does not appear to be any justification for forcing an expensive, inherently unreliable forward-looking cost methodology onto any category of rural telephone company at this time.

IV. ATTEMPTS TO ADDRESS THE INCREASE IN HIGH-COST FUND THROUGH CHANGING THE DEFINITION OF RURAL TELEPHONE COMPANY ARE INAPPROPRIATE

A driving factor for the Joint Board's inquiry appears to be the significant increase in the size of the high-cost fund in recent years. The cause of the increase is twofold. One cause is the removal of implicit subsidies from access rates and recasting the implicit subsidies into support from the universal service fund. That happened with the creation of the ICLS. This "increase" in the size of the fund caused by the transition of the carrier common line portion of access rates to the ICLS is a fully warranted and an expected growth in the size of the high-cost fund.

[25] Comments of TDS Telecommunications Corporation at p. 10-11.

The other cause is the growth in funding for competitive ETCs. While this should have been expected at some level, the growth in funding for CETCs has been surprisingly large. For example, CenturyTel cites to a Legg Mason report that the uncapped funding of CETCs has led to substantial increases in universal service high-cost fund. The Legg Mason report states "The size of the universal service fund … would not be a major concern if it were not for the dramatic growth in CETC payments over the last two years and the potential expansion in the next few years."[26]

It is evident from the material submitted in this record that the cause of the growth of the high-cost fund in recent years is not because there have been significant increases in costs for rural telephone companies that are now supported by the universal service fund. As NECA pointed out in its comments, the rate of growth of the fund due to increases in rural telephone company expenses is less than the rate of inflation.[27] Instead, the driving factor for the growth in the size of the fund is the very large growth in funding for CETCs.

This is not to suggest that CETCs should not be funded. Rather, these facts suggest that the Joint Board and FCC's focus should be on developing a rational policy for the designation of competitive ETCs. In addition, the Commission should examine the basis that should be used to develop the cost for CETCs that are supported by the universal service fund.

To this end, many of the parties filing comments take the position that CETCs should be funded based upon their own costs.[28] Others such as NASUCA and SBC argue that the cost support level for CETC should be set at the lesser of the CETC's own costs or the rural telephone

[26] Comments of CenturyTel, Inc. at p. 9 citing Legg Mason Wood Walker, Inc., Universal Service Financial Analysis, June 25, 2004 at p. 5.
[27] Comments of the National Exchange Carrier Association, Inc. at p. 9.
[28] See, e.g., Comments of the Western Telecommunications Alliance at p. 22 and National Telecommunications Cooperative Association Initial Comments at p. 7.

company's costs. In part, this recommendation is predicated on the concept that the rural telephone company retains the obligations of carrier of last resort.[29] NASUCA states "ILECs continue to serve as the only reliable carrier of last resort, however. Thus, it would not be workable, for example, to limit ILEC support to the level of a lower-cost wireless carrier support."[30] SBC also identifies that there are problems in the way that wireless CETCs receive support for working loops, citing that Western Wireless is receiving universal service support for 30,108 working loops in the Pine Ridge Reservation of South Dakota, even though according to the 2000 Census there were only 14,068 residents on the Reservation.[31]

Still others suggest that the Joint Board would be better off to look at where support should be limited to either one ETC or the incumbent plus one competitive ETC. For example, Verizon argues that there should be only one ETC in some areas.[32] AT&T takes the same position.[33]

These are all concepts that should be considered. The focus should be on the ETC designation process and the cost basis for CETC support. For example, late this month the Washington Utilities and Transportation Commission will consider the application of Sprint PCS for designation as a competitive ETC. In the past, the Washington Commission has granted every ETC application without a hearing, without any analysis of cream-skimming potential and without any concrete evidence of ability of the CETC to serve throughout the area for which designation is sought. If the Sprint PCS application is granted, and there is no reason to doubt it will, this will be the fourth ETC for some very small areas such as Toledo, Washington with

[29] Comments of the National Association of State Utility Consumer Advocates on Rules Relating to Rural High-Cost Universal Service Support at p. 33-34 and Comments of SBC at p. 5.
[30] Comments of the National Association of State Utility Consumer Advocates on Rules Relating to Rural High-Cost Universal Service Support at p. 34.
[31] Comments of SBC Communications, Inc. at p. 6.
[32] Comments of Verizon at p. 15.
[33] Comments of AT&T at p. 5.

approximately 2,200 access lines. This is the area that needs examination. An artificial change to the definition of rural telephone company as a means to relieve some pressure on the high-cost fund is the wrong direction. The focus needs to be on the real issue: the ETC designation process and the cost basis for CETC support.

IV. CONCLUSION

Whichever direction the Commission should travel is a matter for further discussion. However, it is apparent that the current proceeding is misdirected. Further resources should not be expended in discussing artificial limits on the definition of rural telephone company or trying to determine how a forward-looking economic cost model might be jerry-rigged to fit some subset of rural telephone companies. Resources and time are better spent on solving intercarrier compensation issues and solving issues related to the designation and funding of CETCs.

Respectfully submitted this 14th day of December, 2004.

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